UNITED STATES COU^TS
SOUTHERN DISTRICT OF TEXAS
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Michael N. Milby, Clerk of Court

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In Re ENRON CORPORATION SECURITIES, DERIVATIVE & "ERISA" LITIGATION	§ § §	MDL 1446
MARK NEWBY, et al., Plaintiffs vs. ENRON CORPORATION, et al., Defendants	§ § § § § § § § § §	Civil Action No. H-01-03624 And Consolidated Cases (including No. H-03-5528)

REPLY MEMORANDUM IN SUPPORT OF MOTION TO DISMISS OF DEFENDANTS:

THE ROYAL BANK OF SCOTLAND GROUP PLC,
THE ROYAL BANK OF SCOTLAND PLC,
NATIONAL WESTMINSTER BANK PLC,
GREENWICH NATWEST STRUCTURED FINANCE, INC.,
GREENWICH NATWEST LTD.,
AND CAMPSIE, LTD.

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INTRODUCTION

Three aspects of Plaintiffs' opposition brief bear special emphasis. First, this Court ruled on February 25, 2004 (ICERS Order) that Sarbanes-Oxley does not revive previously time-barred claims. Plaintiffs now concede that, under that ruling, their claims based on the Sutton Bridge and LJM1/Rhythms Hedge transactions are barred by the three-year statute of repose. (Pls. Opp. at 5.) These claims must be dismissed.

Second, Plaintiffs concede that if their remaining claims against RBSG are governed by the pre-Sarbanes-Oxley time-bar rules (as indeed they are), then the only claims to survive the statute of repose (before even getting to a limitations analysis) are those based on ETOL II and III. (Pls. Opp. at 21.) Thus, if this Court concludes that Plaintiffs' claims against RBSG are part of the *Newby* proceeding, then Plaintiffs' claims based on the "Nixon" Prepay and ETOL I transactions -- in addition to those based on Sutton Bridge and LJM1/Rhythms Hedge -- must be dismissed.

Third, in their opposition brief, Plaintiffs assert -- for the first time -- that RBSG made false and misleading statements in the course of underwriting Enron securities. (Pls. Opp. Part II.B.2.b.) Those allegations do not appear in any of Plaintiffs' pleadings, and so must be disregarded for purposes of this motion to dismiss. In any event, claims against RBSG based on these statements are time-barred.

Additionally, all of Plaintiffs' claims are barred by either the one-year or the two-year statute of limitations (whichever applies). Alternatively, even if only a portion of the transactions are time-barred, what remains is insufficient to plead primary scheme conduct by RBSG. Because of the interrelated nature of the issues presented by RBSG's motion to dismiss, we have created the following decision tree diagram to show the relationship of the various steps in the analysis:

Decision Tree for RBSG's Motion to Dismiss

1. **Dismiss** claims based on Sutton Bridge and LJM1/Rhythms. As Plaintiffs concede, these claims were barred by the three-year statute of repose before Sarbanes-Oxley was enacted.

2. Determine whether Plaintiffs' claims against RBSG are part of same "proceeding" as *Newby*.

3.a. If same proceeding:

Dismiss claims, as Plaintiffs concede, based on "Nixon" Prepay and ETOL I under three-year statute of repose.

3.b. If new proceeding:

Determine whether Plaintiffs were on inquiry notice more than two years before they asserted claims against RBSG.

4. Determine whether Plaintiffs were on inquiry notice when they wrote to RBSG asserting a present basis for filing suit against RBSG.

5.a. If Plaintiffs were on inquiry notice before 12/3/02:

Dismiss remaining claims (based on ETOL II and III) under one-year statute of limitations.

5.b. If Plaintiffs were not on inquiry notice before 12/3/02:

Dismiss remaining claims because RBSG's alleged involvement in ETOL II and III does not rise to the level of a primary securities violation.

6.a. If Plaintiffs were on inquiry notice before 12/3/01:

Dismiss all claims based on expiration of two-year Sarbanes-Oxley statute of limitations.

6.b. If Plaintiffs were not on inquiry notice before 12/3/01:

Dismiss all claims because RBSG's alleged involvement in "Nixon" Prepay and ETOL I-III does not rise to the level of a primary securities violation.

I. CLAIMS BASED ON THE SUTTON BRIDGE AND LJM1/RHYTHMS HEDGE TRANSACTIONS ARE TIME-BARRED BECAUSE THEY HAD EXPIRED BEFORE SARBANES-OXLEY WAS ENACTED.

In its opening brief, RBSG explained that the Sarbanes-Oxley Act does not revive claims already time-barred when it was enacted, and Plaintiffs' claims based on the Sutton Bridge and LJM1/Rhythms Hedge transactions are thus barred by the three-year repose period. In this Court's February 25, 2004 Order, the Court agreed on the legal point, holding that Sarbanes-Oxley does not revive previously time-barred claims. (Feb. 25 Order at 41-43.) Given this holding, Plaintiffs (apart from disputing the correctness of that holding) implicitly concede that their claims based on Sutton Bridge and LJM1/Rhythms Hedge are time-barred and thus not sustainable; Plaintiffs now argue only that their "claims arising out of the Nixon Prepay and ETOL I, ETOL II, and ETOL III transactions" are not time-barred. (Pls. Opp. at 5.) Accordingly, no matter how this Court resolves any of the legal issues disputed on this motion, the claims based on the Sutton Bridge and LJM1/Rhythms Hedge transactions must be dismissed.

II. THE NEW FACTUAL ASSERTIONS NOT PLED IN ANY COMPLAINT BUT RAISED FOR THE FIRST TIME IN PLAINTIFFS' OPPOSITION PAPERS MUST BE DISREGARDED.

Plaintiffs devote a subsection of their opposition brief to asserting that RBSG "sold Enron securities" through offering memoranda that allegedly contained "false and misleading statements." (Pls. Opp. Part II.B.2.b, at 29-31.) In support of these allegations, they cite to the May 14, 2003 *Newby* amended complaint. *Id.* In truth, neither that complaint nor any other pleading in this case ever mentions RBSG in connection with the offering of any Enron security. In fact, none of the names of the RBSG entities in this case appears anywhere in the 648-page *Newby* amended complaint. The allegations about RBSG underwriting activity are made only in the opposition brief. "For Rule 12(b)(6) motions, a district court may only consider the allegations in the complaint and any attachments." *Travis v. Irby*, 326 F.3d 644, 648 (5th Cir. 2003). "[I]t is axiomatic that the complaint may not be amended by the briefs in opposition to a motion to dismiss." *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1107 (7th Cir. 1984) (citing cases). In particular, "facts that are offered [in plaintiffs' opposition brief] but that do not appear in the . . . Complaint will not be considered." *Dietrich v. Bauer*, 76 F. Supp. 2d 312, 328 (S.D.N.Y. 1999). Because Plaintiffs' assertions about RBSG's connection to the offering of Enron securities do not appear in any pleading, those assertions must be disregarded for purposes of this motion to dismiss.[1]

III. CLAIMS AGAINST RBSG ARE BARRED BY THE APPLICABLE *LAMPF* TIME-BAR RULES.

A. THE *LAMPF* TIME-BAR RULES APPLY BECAUSE PLAINTIFFS' CLAIMS AGAINST RBSG ARE PART OF A "PROCEEDING" COMMENCED BEFORE THE ENACTMENT OF SARBANES-OXLEY.

The *Newby* proceeding, of which Plaintiffs' claims against RBSG are a consolidated part, was commenced on October 22, 2001. Plaintiffs joined a number of bank defendants, not including RBSG, in their Consolidated Complaint filed April 8, 2002. In that pleading, Plaintiffs alleged many of the events and circumstances now forming the basis of their claims against RBSG. (*See, e.g.*, Consolidated Compl. ¶¶ 23, 32-33, 62, 385, 448-59, 466-68, 816-18, 836-37, 848-49, 878 (discussing LJM1, the Rhythms Hedge, and Cuiaba), ¶ 684 (discussing Citigroup prepay transactions.) On April 16, 2002, the Judicial Panel on Multidistrict Litigation

[1] Apart from the fact that they are not pled in any complaint, Plaintiffs' assertions against RBSG related to underwriting Enron securities, even if alleged, would be time-barred. As this Court has observed, Plaintiffs' Section 11 and Section 12(a)(2) (underwriting) claims in the First Amended Consolidated Complaint are based on strict liability and/or negligence, and thus are governed by the *Lampf* time-bar rules. (Feb. 25 Order at 40.) Of the four offering memoranda attached to Plaintiffs' opposition papers, one is dated February 15, 2000. Any claim based on that offering is barred by the three-year repose period. The remaining three, all dated May 17, 2001, are barred by the one-year limitations period. This Court has held that Plaintiffs were on inquiry notice as to claims based on credit-linked note (CLN) offerings as of September 29, 2002, the date Conseco published notice of its commencement of litigation on behalf of CLN purchasers. (*See* Feb. 25 Order at 62-63. *See also* Mar. 31, 2004 Order re Lehman Defendants' Mot. to Dismiss, at 5 (noting "storm warnings for [CLN] offerings . . . were in the fall of 2002").) Plaintiffs allowed more than a year to run after they had inquiry notice before joining RBSG.

commenced the current multidistrict proceeding, *In re Enron Corporate Securities Litigation*, MDL-1446. The current "proceeding" was thus commenced well before July 30, 2002, the effective date of Sarbanes-Oxley.

In this Court's February 25, 2004 Order, the Court addressed whether a new pleading adding new parties was a "new proceeding" that would be governed by the Sarbanes-Oxley time-bar rules. The Court noted that the new pleading involved there -- specifically, the May 14, 2003 First Amended Consolidated Complaint -- (1) was based on wrongdoing that occurred before the filing of the First Amended Consolidated Complaint, and (2) involved much the same facts and similar parties. (Feb. 25 Order at 44-45.) The Court therefore did not construe the claims in the new pleading "as a 'new proceeding' and conclude[d] that its claims are not governed by the lengthened statute of limitations . . . ." (*Id.*) Here, like there, Plaintiffs' charge against RBSG, which was promptly consolidated with *Newby*, (1) is based on wrongdoing that occurred before the filing of the First Amended Consolidated Complaint (indeed, before the original *Newby* complaint), and (2) involves much the same facts and similar parties. In its March 29, 2004 Order (Merrill/Deutsch), this Court reiterated that it had "previously rejected [the] argument" that "claims against newly added Defendants . . . commenced by [a] new complaint [filed] after the Act's enactment" should be governed by the extended Sarbanes-Oxley limitations period. (Mar. 29 Order at 37.) The claims asserted by Plaintiffs against RBSG are governed by the *Lampf* time-bar rules.

1. Plaintiffs' Pleading Against RBSG Is Based On Conduct Predating The Initial Complaint.

To determine whether a new pleading constitutes a "new proceeding" for purposes of Sarbanes-Oxley's extended limitations period, this Court explained that the important, relevant distinction was whether the new pleading alleged new events that happened *after* the filing of the initial pleading, or simply modified or added to previous allegations about events that occurred *before* the initial pleading. (Feb. 25 Order at 43.) Plaintiffs' pleading against RBSG is simply a modification of and addition to allegations already pled by Plaintiffs in prior pleadings, such as the May 14, 2003 First Amended Consolidated Complaint, and the earlier April 8, 2002 Consolidated Complaint, about the same course of conduct, and the same or similar transactions. Indeed, none of the events challenged as to RBSG postdate the October 2001 commencement of *Newby*. Plaintiffs' pleading bringing in RBSG is not a "new proceeding."

2. Plaintiffs' Pleading Against RBSG Is Based On Much The Same Facts And Similar Parties.

The claims against RBSG encompass the same course of events and much the same actions as those previously asserted in Plaintiffs' pleadings in this case. The exact same plaintiffs proposing to act in the exact same representative capacity, are charging the same scheme-based securities claims that involved many of the previously-named defendants (such as the Enron Insiders and banks including Citigroup and CSFB). Indeed, many of the details surrounding the LJM1/Rhythms Hedge transaction that are included in the claims against RBSG appeared long ago. (*See* Consolidated Compl. ¶¶ 32-33, 448-59, 816, 836-37, 848-49, 878 (discussing LJM1/Rhythms Hedge); First Am. Consolidated Compl. at ¶¶ 32-33, 448-59, 816, 836-37, 848-49 (same).)[2] Similarly, Plaintiffs grounded claims against Citigroup in the First Amended Consolidated Complaint on Citigroup's involvement in, among other things, prepay transactions. (*See id.* at ¶ 684 (same allegations in both complaints).) The claims against RBSG are also based in part on a Citigroup prepay. (*See* Compl ¶ 33.)

[2] What is more, LJM1 (LJM Cayman, L.P.) was itself named as an actual defendant as early as October 23, 2001, in a case now part of the *Newby* proceeding. (*See* Pls. First Am. Pet., *Coy v. Fastow*, Cause No. 2001-54202 (filed Oct. 23, 2001 in 270th Judicial District, Harris County, Texas), on removal, No. 4:01-CV-3995 (S.D. Tex.).)

Moreover, Plaintiffs themselves treat their claims against RBSG as part and parcel of the *Newby* proceeding. Lead Plaintiff acknowledges that it did not initiate the procedures required for appointment of lead plaintiff and lead counsel for its supposedly "new proceeding" against RBSG, but instead operated on the (correct) view that the RBSG pleading was effectively a part of, and thus would be immediately consolidated into, *Newby*. They continue that same treatment of *Newby* in this very motion; their response repeatedly cites to the May 14, 2003 *Newby* amended complaint to justify and support the validity of claims against RBSG here. (Pls. Opp. at 29-30.) For all purposes other than their hope for a new statute of limitations, Plaintiffs understand their claims against RBSG to be, and treat them as, integral to the ongoing *Newby* proceeding.

This Court, quoting *Gerber v. MTC Elec. Techs. Co.*, 329 F.3d 297, 310 (2d Cir. 2003), noted that "[i]n the absence of any indication to the contrary, we doubt that Congress intended that courts would apply different sets of substantive and procedural rules to groups of plaintiffs asserting identical claims in a single action, depending on when those plaintiffs were added to the complaint." (Feb. 25 Order at 54-55 (quoting *Gerber*, 329 F.3d at 310).) This reasoning applies equally to the various defendants now facing the same claims in the *Newby* proceeding: absent a clear indication to the contrary (and there is none), there is no reason to think that the same claims in the same case against different defendants should be governed by different sets of rules based on when those defendants were joined.[3]

[3] For example, Plaintiffs' claims against RBSG and CSFB based on those banks' connections to the LJM1/Rhythms Hedge transaction are founded on the same factual allegations. Plaintiffs allege that both banks contributed an equal capital investment to LJM1, and that Enron improperly failed to consolidate LJM1. Despite the "identical claims" against RBSG and CSFB, *Gerber*, 329 F.3d at 310, Plaintiffs' theory would have the part of this claim against RBSG governed by a different set of rules than the part of the claim against CSFB, only because Plaintiffs joined RBSG later than they joined CSFB. So, too, with the so-called "Nixon" prepay transaction, where Citigroup's participation and that of RBSG would, although contemporaneous, be assessed under different rules for claim timelines purposes. This is precisely the odd result rejected in *Gerber* and in this Court's Orders of February 25 and March 29, 2004.

3. Sarbanes-Oxley Applies Only To a New Proceeding, Not Merely To New Parties Or New Claims.

As explained in this Court's February 25 Order, Sarbanes-Oxley applies only to new *proceedings*, not to new *claims* or new *parties* in ongoing proceedings. In *Gerber*, the court "affirmed the district court's holding that where the action was filed before the date of the enactment of the PSLRA, because the statute refers to 'actions,' not to 'parties' or 'claims,' the Act did not apply to parties and claims added after the enactment of a pre-existing suit." (Feb. 25 Order at 54.) Similarly, "[i]n the case of the Sarbanes-Oxley Act, the extended limitations provision refers to 'proceedings,' not to claims or parties." (*Id.* at 55.)

While both *Gerber* and this Court's February 25 Order involved the addition of new plaintiffs rather than new defendants, the analysis and language in both decisions make clear that this does not alter the result. This Court repeatedly spoke in terms of new "parties," not just new "plaintiffs." (*See id.* at 52 n.42 (plaintiffs cannot circumvent the limitations period by "fil[ing] a new second suit or a new claim or add[ing] a new party"); at 54 ("the [PSLRA] did not apply to parties and claims added after the enactment to a pre-existing suit"); at 55 ("the extended [Sarbanes-Oxley] limitations provision refers to 'proceedings,' not to claims or parties").) If there were any doubt in this regard, this Court clarified in its March 29 Order that it had "previously rejected [the] argument" that "claims against newly added *Defendants* . . . commenced by [a] new complaint [filed] after the Act's enactment" should be governed by the extended Sarbanes-Oxley limitations period. (Mar. 29 Order at 37 (emphasis added).)

The decision in *McKowan Lowe & Co. v. Jasmine, Ltd.*, 976 F. Supp. 293 (D.N.J. 1997), confirms that the same rule applies to newly-added defendants as to newly-added plaintiffs. In *McKowan*, the plaintiffs added new defendants to a pre-existing action after the effective date of the PSLRA. *Id.* at 295. The new defendants, sued for the first time after the enactment of the

PSLRA, argued that the PSLRA's heightened pleading requirements for securities claims should apply to the plaintiffs' claims against them. *Id.* at 297. The defendants argued that "an action is commenced against a new defendant with the filing of the amended complaint adding that party." *Id.* The court disagreed, explaining that "the word 'commenced' in Section 108 of the Reform Act means the date the [initial] lawsuit was filed," not the date the defendants were added. *Id.* at 298. The court held that the new PSLRA requirements did not apply to the plaintiffs' claims against the newly-added defendants. *Id.*[4]

4. A New Pleading Destined For Prompt Consolidation Is Functionally Equivalent To An Amended Pleading.

Just as the applicability of the new Sarbanes-Oxley time-bar rules cannot depend on whether the newly-added parties are plaintiffs or defendants, neither can it turn on whether the new parties are added by way of an amendment to the existing complaint or the filing of a separate complaint destined from the outset to be consolidated with the existing action. Plaintiffs could just as easily have joined RBSG by means of an amended complaint as by filing a separate complaint that was always intended to be (and promptly was) consolidated into *Newby*. Indeed, from the very start, the Court's own *Newby* scheduling order specifically contemplated the potential that plaintiffs (or other existing parties) might seek to add new defendants to the *Newby*

[4] In *Gerber* and *McKowan*, the courts refused to apply an intervening statute imposing new burdens on plaintiffs to newly-added plaintiffs and defendants; the result was to the benefit of the newly-added plaintiffs (in *Gerber*) and to the detriment of the newly-added defendants (in *McKowan*). To take a contrary approach here, and apply the intervening Sarbanes-Oxley Act to newly-added defendants, would result in a legal regime in which a new statute is applied to newly-added parties when the statute benefits plaintiffs but is not applied when the statute benefits defendants. The only principled rule consistent with *Gerber* and *McKowan* is that an intervening statute will not be applied to newly-added parties in a pending proceeding, whether that change in the law benefits plaintiffs or defendants.

The one case cited by Plaintiffs in support of their position, *Community Found. for Jewish Educ. v. Fed. Ins. Co.*, No. 00-2276, 2001 U.S. App. LEXIS 13764 (7th Cir. June 12, 2001) (unpublished) (hereinafter, *CFJE*), is inapposite. In *CFJE*, the court was asked to interpret an insurance policy providing coverage for "*claims* first made against the insured during the policy period." *Id.* at *7 (emphasis added). Of course, as this Court has observed, Sarbanes-Oxley speaks in terms of "proceedings" rather than "claims." In fact, this was the critical distinction leading the Court to conclude that new "claims" brought by the ICERS plaintiffs were nonetheless part of the same "proceeding." The *CFJE* court's analysis of when a new "claim" is made has no bearing on this case.

proceeding, and set a date by which that addition must occur. (*See* Feb. 28, 2002 Scheduling Order, Docket No. 326, at 5 (addition by January 1, 2003); July 11, 2003 Scheduling Order, Docket No. 1561, at 6 (revised; addition by January 10, 2004); March 12, 2004 Scheduling Order, Docket No. 2019, at 1 (revised; addition by August 2, 2004).) These orders, of course, did not change any time-bar rules, but they did set parameters for when new parties/claims would be within these proceedings.

Plaintiffs' October 2002 tolling letter shows that Plaintiffs always intended to sue RBSG as part of *Newby* until they realized they had let the limitations period expire. In the October 2002 letter, Lead Plaintiff does not mention the possibility of filing a separate suit against RBSG. Instead, under the heading "Re: *Enron Corporate Securities Litigation*," Lead Counsel warns RBSG of Lead Plaintiff's "basis for naming [RBSG] . . . as defendants" in the pending action, and states that absent the execution of a tolling agreement, Lead Plaintiff will "name Royal Bank of Scotland, Plc. and Natwest as defendants on or before October 16, 2002." (RBSG's Mot. to Dismiss, Ex. A.) That addition would, of course, have been within the time allowed by the Court's scheduling order then in effect. Lead Counsel's subsequent decision to file a separate complaint against RBSG rather than directly joining it in the pending action appears to have been motivated solely by Plaintiffs' hope to manipulate the legal landscape through substantively meaningless pleading machinations. If Plaintiffs' position were accepted, they could readily have avoided the *Lampf* time-bar rules for their claims against the later-added bank defendant entities (such as Deutsche Bank Securities, Inc., DB Alex. Brown LLC, and Deutsche Bank Trust Company Americas) by joining them through a separate complaint promptly consolidated rather than by an amended complaint, as they did.

This Court has already explained that Plaintiffs cannot so easily circumvent the statute of limitations. In its February 25 Order, this Court noted that in *Friedman v. Rayovac Corp.*, No. 02-C-308-C (W.D. Wis. May 29, 2003), the court had held that an amended complaint constitutes a new proceeding "since the plaintiffs could have simply filed a separate new suit." (Feb. 25 Order at 52 n.42.) This Court disagreed, explaining that *neither* scenario would result in a "new proceeding": "[t]o permit a plaintiff to file *a new second suit* or a new claim or add a new party in order to circumvent a statute of limitations and expand his legal rights, especially where the clear language of the statute reflects Congress' intent not to permit such expansion, as here, would create legal chaos." (*Id.*) (emphasis added). Both the *Friedman* court and this Court recognized the need, in this type of context, to treat an amendment and a new lawsuit under the same time-bar rule. The difference is that *Friedman* worked backwards, saying that a new lawsuit would avoid the rule, so an amendment should also; this Court, by clear contrast, worked forward, saying that adding a new party or claim via amendment would not cause a different rule to apply, so substituting a new lawsuit would likewise not do so. *See also Beck v. Albany Medical Center Hosp.*, 594 N.Y.S.2d 844, 846-47 (N.Y. App. Div. 1993) (declining to apply amended statute applicable to actions commenced on or after July 1, 1985 to newly-named defendant who was served during July 1985 "in a separate action subsequently consolidated with this action").

Plaintiffs offer no rationale for why the addition of new parties by way of a new complaint slated from the outset for consolidation into an existing action should be treated differently from the addition of new parties by way of an amended complaint. The only apparent rationale is their hope of being permitted to evade the consequences of the "same proceeding" rule articulated in this Court's February 25 and March 29 Orders. As those Orders and other caselaw make clear, Plaintiffs' claims against RBSG are part of the current proceeding, which was pending well before Sarbanes-Oxley was enacted. The *Lampf* one-year limitations and three-year repose periods govern Plaintiffs' claims against RBSG.[5]

B. CLAIMS AGAINST RBSG ARE BARRED BY THE *LAMPF* ONE-YEAR STATUTE OF LIMITATIONS.

Lead Plaintiff's October 3, 2002 letter unequivocally states that Plaintiffs were on inquiry notice of claims against RBSG more than a year before they joined RBSG on December 3, 2003. Plaintiffs try to deflect the overwhelming import of this letter by arguing that inquiry notice can never be resolved on a motion to dismiss. (Pls. Opp. at 11 ("the issue of inquiry notice cannot be resolved on the pleadings alone").) As this Court's March 29 Order makes clear, that is not true. (*See* Mar. 29 Order at 30 n.27 (finding, on a motion to dismiss, that Plaintiffs were on inquiry notice of tax schemes on "May 22, 2002, the date of publication of the first *Washington Post* article on the STDs[,] . . . the date a reasonably prudent person would have been put on notice.").) *See also In re Sioux, Ltd. Sec. Litig.*, 901 F.2d 51, 53 (5th Cir. 1990) ("We hold that, as a matter of law, the plaintiffs were on inquiry notice of the facts giving rise to their causes of action before June 13, 1982."), *opinion withdrawn and superseded on other grounds*, 914 F.2d 61 (5th Cir. 1990); *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 352 n.3 (2d Cir. 1993) (The "suggestion that the question of constructive notice [inquiry notice] is an improper subject for

[5] Lacking any doctrinal rationale for treating a separate complaint promptly consolidated differently than an amended complaint, Plaintiffs ask "If the Complaint against [RBSG] . . . cannot receive the benefit of the extended limitations period, then who can properly bring suit?" (Pls. Opp. at 10.) Plaintiffs' rhetorical concern is unjustified. It is not surprising that claims by one plaintiff against multiple defendants based on the same transactions occurring between 1999 and 2001 should be governed by the statute of limitations in effect at that time, or that all defendants in the case should be governed by the same limitations period, or that claims asserted for the first time in December 2003 are time-barred. The fact that too much time has passed for *anyone* to sue RBSG on a federal securities claims provides no basis for ignoring the time-bar rule in favor of some specially annointed representative. It is also hard to take seriously Plaintiffs' supposed concern that no party could have brought suit against RBSG in a timely manner when Lead Plaintiff itself sent RBSG a letter asserting "[o]ur continuing investigation reveals a basis for naming [RBSG] . . . as defendants [in *Enron Corporation Securities Litigation*]," many months before the First Amended Consolidated Complaint was filed and well over a year before Plaintiffs finally joined RBSG. (*See* RBSG Mot. to Dismiss, Ex. A.)

Plaintiffs' citation to the legislative history adds nothing to the analysis. Plaintiffs' claim that Senator Leahy's reference to "all cases" somehow means something different than the Act's own language of "all proceedings" only shows the insubstantiality of Plaintiffs' argument. (Pls. Opp. at 11.) The word "case" can, resolution as a matter of law is contradicted by a vast number of cases in this circuit resolving these issues at the pleading stage.") (citing cases).

In this case, under the *Lampf* regime, Plaintiffs have saved the Court the effort of inferring from circumstantial evidence when it was, precisely, that Plaintiffs were on inquiry notice, because they specifically wrote in October 2002 that this was the case. Once plaintiffs are on notice of facts "form[ing] part of the basis for [their] suit . . . Plaintiffs [are] put on inquiry notice." *Andrews v. Fitzgerald*, 823 F. Supp. 356, 366 (M.D.N.C. 1993) (internal citation omitted). Here, Lead Plaintiff told RBSG on October 3, 2002 that it had discovered "a basis for naming Royal Bank of Scotland, Plc., and National Westminster, Bank, Plc. ('NatWest') as defendants" in this suit. (RBSG Mot. to Dismiss, Ex. A.) Plaintiffs argue that "[s]uch a statement is not sufficient to trigger the running of the statute." (Pls. Opp. at 16.) If Lead Plaintiff's express assertion of a present awareness of a cause of action against RBSG is not sufficient to show inquiry notice, it is hard to imagine what could. In fact, Plaintiffs' October 2002 letter says not only that Plaintiffs had knowledge "of the facts forming the basis of [their] cause of action" (the only knowledge necessary for inquiry notice), but that they were also aware of "the existence of the cause of action itself," *Jensen v. Snellings*, 841 F.2d 600, 606 (5th Cir. 1988), and, absent a tolling agreement, intended to "name" the banks "as defendants" no later than mid-October 2002. (RBSG Mot. to Dismiss, Ex. A.)[6]

Plaintiffs also attempt to discount their inquiry notice letter by asserting that the "basis for naming" RBSG referred to in the October 2002 letter is different from the basis settled on by

(continued...)

in some contexts, be synonymous with "proceeding," just as both of those terms can be synonymous with "action," the term used in the PSLRA and analyzed in *Gerber*.

[6] If Plaintiffs did not have a basis for naming RBSG in October 2002, then they deceived RBSG in order to procure a tolling agreement. The only reason Lead Plaintiff sought a tolling agreement (which Lead

Plaintiffs when they finally joined RBSG in December 2003. Plaintiffs take the position that a plaintiff is not on inquiry notice until it has learned every detail of the alleged fraud, and claim that they did not learn the full scope of each bank's alleged involvement until the Examiners' Final Report on November 24, 2003. The law is clear, however, that "[i]nquiry notice is triggered by evidence of the possibility of fraud, not full exposition of the scam itself." *Theoharous v. Fong*, 256 F.3d 1219, 1228 (11th Cir. 2001) (citation omitted). "An investor does not have to have notice of the entire fraud being perpetrated to be on inquiry notice." *Dodds*, 12 F.3d at 352. *See also Andrews*, 823 F. Supp. at 366 (plaintiffs are on inquiry notice when they know of facts that "form *part* of the basis for [their] suit . . . .") (emphasis added).[7] If and when plaintiffs, having filed initially in a timely manner, discover additional or alternative grounds for asserting claims against defendants, they are free to amend their pleadings to expand or refine their allegations -- as Plaintiffs have done here repeatedly as to other defendants. What the law does not permit, however, is for a plaintiff to sit on its rights and await the complete exposition of minute details of an alleged fraud before filing suit against an alleged participant in that fraud. That is precisely what Plaintiffs have done as to RBSG, and because of their extended inaction, all of their claims have become barred by the one-year *Lampf* statute of limitations.

(continued...)

Plaintiff inexplicably allowed to expire) was that it knew the statute of limitations had been triggered by its discovery of a basis for naming RBSG. The Court should hold Lead Plaintiff to its word.

[7] Besides, as we point out elsewhere, there was public knowledge about LJM1 and the involvement of RBSG's predecessor, NatWest, over two years before the filing against RBSG. (*See infra* at pp. 14-16). And the involvement of RBSG in a "prepay" had been widely broadcast in July 23, 2002 public Congressional hearings. *See* Testimony of Robert Roach, Chief Investigator, Senate Government Affairs Permanent Subcommittee on Investigations, *The Role of Financial Institutions in Enron's Collapse*, at 3 (July 23, 2002), attached as Ex. A. Any suggestion that Plaintiffs were in the dark about RBSG until just a couple of weeks before they filed against RBSG is pure hokum.

C. CLAIMS BASED ON THE "NIXON" PREPAY AND ETOL I TRANSACTIONS ARE BARRED BY THE *LAMPF* THREE-YEAR REPOSE PERIOD.

Apart from the one-year limitations period, Plaintiffs concede that if the *Lampf* three-year repose period governs their claims against RBSG, then the only claims not barred by repose are those "based on [RBSG's alleged] . . . participation in ETOL II and ETOL III." (Pls. Opp. at 21.) Thus, if the Court concludes (as we believe the law requires) that Plaintiffs' claims against RBSG are part of the *Newby* proceeding, then Plaintiffs' claims based on the "Nixon" Prepay and ETOL I transactions are, without need for any further inquiry, barred by the three-year statute of repose and must be dismissed.[8]

IV. CLAIMS AGAINST RBSG ARE TIME-BARRED EVEN UNDER THE TWO-YEAR SARBANES-OXLEY STATUTE OF LIMITATIONS.

Plaintiffs' claims should be dismissed even if the extended Sarbanes-Oxley two-year statute of limitations applies. This Court has noted that "[l]ike a rock thrown into the water, increasing disclosure of the involvement of numerous parties expanded ever outward to embrace accountants, law firms, and banks." (Feb. 25 Order at 63.) The critical question for this motion, then, is whether this pleading record shows those ripples had expanded to encompass RBSG more than two years before Plaintiffs filed suit. As demonstrated in RBSG's opening brief, they had.

Plaintiffs argue that "fraud by Enron could not have reasonably been read . . . as fraud by all who did business with Enron." (Pls. Opp. at 15.) But the facts here do not allow such a

[8] Plaintiffs implicitly concede this point: "[I]f [RBSG] is correct that the three-year statute of repose applies and bars plaintiffs' claims with respect to the transactions entered prior to December 2000, plaintiffs still have a timely § 10(b) claim . . . based on [RBSG's alleged] . . . participation in ETOL II and ETOL III." (Pls. Opp. at 21.) Plaintiffs then misstate RBSG's position, saying: "Indeed, [RBSG] concedes that, even under their interpretation of the law, plaintiffs have a claim based on . . . ETOL II and ETOL III." (*Id.*) To be sure, RBSG does not suggest that ETOL II and III are barred by the three-year statute of repose, but RBSG manifestly does *not* concede that Plaintiffs "have a claim" based on those transactions. Repose aside, claims based on ETOL II and III are barred by either the one-year or the two-year statute of limitations (whichever applies), not to mention by Plaintiffs' failure to plead RBSG's primary violation of the securities laws.

generalized response to our motion: RBSG has identified facts specific to it and to the LJM1 transaction "form[ing] part of the basis for [Plaintiffs'] suit" against RBSG, that were well and publicly known, and even cited in lawsuits, more than two years before the filing now under examination here. *Andrews*, 823 F. Supp. at 366. Referring again to just a small portion of the public data, the record shows unequivocally that well before December 3, 2001, it had been publicly disclosed that:

1. "Greenwich NatWest and Credit Suisse collectively own a 94% interest in LJM Cayman, L.P." (Form U-57, Enron Corp. (Aug. 4, 2000), RBSG Mot. to Dismiss, Ex. F at 2).

2. "LJM Cayman, L.P. ('LJM1') . . . [is a] private investment limited partnership[] . . . formed in 1999. . . . Enron believes that the LJM partnerships have as limited partners a significant number of *institutions and other investors that are not related parties to Enron. . . .* The financial activities of a wholly-owned subsidiary of LJM1, which engaged in derivative transactions with Enron to permit Enron to hedge market risks of an equity investment in Rhythms NetConnections, Inc., should have been consolidated into Enron's financial statements beginning in 1999." (Form 8-K, Enron Corp. (Nov. 8, 2001), RBSG Mot. to Dismiss, Ex. D at 3-4) (emphasis added).

3. In connection with the Rhythms Hedge, "LJM1 received 6.8 million shares of Enron common stock subject to certain restrictions, 3.1 million shares of which it contributed to the LJM1 subsidiary." (Form 10-Q, Enron Corp. (Nov. 19, 2001), excerpts attached as Ex. B at 16).[9]

Thus, by no later than November 19, 2001, the public had been specifically informed that LJM1 had been substantially capitalized with Ernon's own shares, which in turn were the support for the hedge, that the LJM1/Rhythms Hedge had been accounted for improperly, that independent institutional investors were limited partners in LJM1, and that LJM1 had been formed in 1999. The most cursory investigation suggested by these facts -- a review of Enron's 1999 SEC filings disclosing LJM1 -- would have quickly revealed NatWest as a significant stakeholder in LJM1. In light of these facts, "an ordinary investor [should] reasonably have

[9] The full text of this Form 10-Q is available on the SEC's website, at http://www.sec.gov/Archives/edgar/data/1024401/000095012901504218/0000950129-01-504218.txt.

recognized that his interest was being harmed and that an investigation should be undertaken." (Mar. 29 Order at 51-52.)

Moreover, the Enron plaintiff world in fact knew information disclosed in Enron's SEC filings: a complaint filed on November 30, 2001 (now a part of *Newby*) pleads that "a wholly-owned subsidiary of LJM1, which engaged in derivative transactions with Enron to permit Enron to hedge market risks of an equity investment in Rhythms NetConnections, Inc., should have been consolidated . . . because of inadequate capitalization." (Class Action Compl. for Violations of the Federal Securities Laws ¶¶ 64, 67, *Davis v. Enron Corp.*, 5:01-CV-313-TJW (E.D. Tex. filed Nov. 30, 2001), on transfer, No. 4:02-CV-1830 (S.D. Tex.).)[10] Nonetheless, Plaintiffs neglected to file suit against RBSG (defined here as including NatWest) until more than two years after these disclosures.

Plaintiffs assert that these facts did not put them on notice of RBSG's alleged "securities violations." (Pls. Opp. at 15.) That assertion is based on a mischaracterization of the proper legal standard. Inquiry notice does not require that Plaintiffs be aware of the securities violation -- "the existence of the cause of action itself" -- but "merely . . . of the facts forming the basis of [the] cause of action," *Jensen*, 841 F.2d at 606, or that "an ordinary investor [should] reasonably have recognized that his interest was being harmed and that an investigation should be undertaken." (Mar. 29 Order at 51-52.)[11]

[10] *See also* Class Action Compl. for Violations of the Federal Securities Laws ¶¶ 113-14, *Amalgamated Bank v. Lay*, 4:01-CV-4198 (S.D. Tex. filed Dec. 4, 2001) (discussing LJM1/Rhythms); Class Action Compl. for Violations of the Federal Securities Laws ¶¶ 64, 67, 87, *Duncan v. Lay*, 5:01-CV-319-TJW (E.D. Tex. filed Dec. 6, 2001), on transfer, No. 4:02-CV-1828 (S.D. Tex.) (same).

[11] Plaintiffs incorrectly assert that that this Court recently "held," (Pls. Opp. at 13), that the limitations period begins to accrue on the "date on which an investor . . . would have discovered the fraud . . . ." *Young v. Lepone*, 305 F.3d 1, 9-10 (1st Cir. 2002). RBSG does not understand this Court to have "held" or even hinted that it has adopted the First Circuit's approach in this regard. While the Court does quote *Young* in its February 25 Order, the Court also quotes the Seventh Circuit's conflicting decision in *Fujisawa Pharmaceutical v. Kapoor*, 115 F.3d 1332 (7th Cir. 1997), in which Judge Posner states that the limitations period "begins to run not when the fraud occurs, *and not when the fraud is discovered,* but when (often *between* the date of occurrence and the date of discovery of the fraud) the plaintiff learns, or should have learned . . ., enough facts to enable him *by such further investigation* as the facts would induce in a reasonable

Because Enron's public disclosures before December 3, 2001 put Plaintiffs on inquiry notice -- indeed, very sharp and specific notice -- of facts underlying claims now asserted against RBSG, Plaintiffs' claims are barred by even the two-year Sarbanes-Oxley statute of limitations. Those claims must be dismissed.

V. EVEN IF CERTAIN ALLEGATIONS WERE TO SURVIVE THE TIME BARS, THOSE REMAINING ALLEGATIONS DO NOT RISE TO THE LEVEL OF A PRIMARY VIOLATION OF THE SECURITIES LAWS.

If all of Plaintiffs' claims are time-barred, the Court need not consider whether Plaintiffs have pled a primary violation against RBSG. In the event some of Plaintiffs' claims survive the time bars, then the Court should consider only those surviving transactions in determining whether Plaintiffs' allegations against RBSG rise above an inadequate aiding and abetting claim to the level of a primary violation of the securities laws. Plaintiffs fail to identify timely allegations of active, deceptive conduct in a scheme to defraud by RBSG that rises to the level of a primary violation. For this independent reason, Plaintiffs' claims must be dismissed.

Much of the supposed active, deceptive conduct identified by Plaintiffs in Part II.B.2 of their opposition brief relates only to the Sutton Bridge and LJM1/Rhythms Hedge transactions, even though Plaintiffs have already conceded, earlier in their brief, that claims based on these transactions are time-barred. As this Court held in its March 29 Order, time-barred transactions cannot be considered when determining whether Plaintiffs' allegations state a claim for a primary violation of the securities laws. (Mar. 29 Order at 40-41 (Even though the "six distinct STDs" would have "stated a claim against the Deutsche Bank Entities as secondary actors

(continued...)

person to sue within a year." 115 F.3d at 1334 (emphasis added). The standard articulated in this Court's March 29 Order (quoted above) reflects the *Fujisawa* approach. *See also Columbraria Ltd. v. Pimienta*, 110 F. Supp. 2d 542, 548 (S.D. Tex. 2000) (adopting *Fujisawa* formulation). In the February 25 Order, the Court quoted both *Young* and *Fujisawa* merely for the proposition that the "inquiry-notice or storm-warning rule (as opposed to actual notice) has become the majority view." (Feb. 25 Order at 30.) The *Young* rule improperly committing primary violations of § 10(b) and Rule 10b-5, . . . [b]ecause the time bar of limitations reduces the number of viable claims to just a single STD, again, without the pattern of tax schemes, the pleadings fail to meet the requirements of the PSLRA."); *see also id.* at 75.)[12]

Second, Plaintiffs devote another portion of Part II.B.2 to discussing supposed false and misleading statements by RBSG in offering memoranda, even though there are no allegations to this effect anywhere in the Plaintiffs' various complaints (and even though these assertions, if alleged, would be time-barred). This Court must disregard allegations made for the first time in a brief opposing a motion to dismiss (*see supra* Part II), and also, independently, those that are time-barred. All that remains is Plaintiffs' discussion on pages 27 to 29.

A. ONLY CLAIMS BASED ON ETOL II AND III SURVIVE THE REPOSE PERIOD, AND ALLEGATIONS OF INVOLVEMENT IN THOSE FOLLOW-ON SITUATIONS FAIL TO STATE A PRIMARY SECURITIES LAW VIOLATION.

If this Court confirms (as it has said many times to date) that the *Lampf* time-bar rules apply to all of Plaintiffs' claims in this proceeding, then (as Plaintiffs concede) the only claims not barred by the repose period are ETOL II and III. (Pls. Opp. at 21.) This Court recently held that "[a]llegations based on a single tax scheme . . . are not sufficient to sustain a claim of a primary violation of § 10(b)." (Mar. 29 Order at 75.) Even less remains of Plaintiffs' allegations

(continued...)

delays a finding of inquiry notice until the "the existence of the cause of action itself" is discovered, *Jensen*, 841 F.2d at 606, and this Court properly did not adopt that approach.

12 Plaintiffs insist that their allegations regarding Sutton Bridge and LJM1/Rhythms are nonetheless relevant to show RBSG's scienter. (Pls. Opp. at 21.) But state of mind and actionable conduct are two different things. Plaintiffs' argument has no bearing on whether Plaintiffs have adequately pled the type of active, deceptive *conduct* necessary to state a Section 10(b) claim. In addition, it is uncertain that allegations related to time-barred conduct would even be considered when evaluating whether Plaintiffs have alleged scienter. (*See* Mar. 29 Order at 41 ("[B]ecause the Court finds that the claims based on the STDs are time-barred, the Court finds that the pleadings, without those claims, are insufficient to raise the requisite strong inference of scienter and to state a claim against the Deutsche entities under § 10(b).").) In any event, anticipatory rulings on trial evidence do not govern the disposition of this motion.

Plaintiffs' assertion that "Royal Bank of Scotland implicitly admits . . . [that it] acted with the requisite scienter to commit securities fraud" is of course incorrect. (Pls. Opp. at 22.) RBSG's decision not to move to dismiss claims on certain grounds is not an admission of the *truth* of those allegations.

against RBSG -- not even a "single . . . scheme," but only these two small follow-ons to a time-barred foundation, ETOL I. Such paltry cognizable involvement is not sufficient to rise to the level of a primary violation of Section 10(b). Plaintiffs' claims against RBSG must therefore be dismissed.

B. EVEN IF THE "NIXON" PREPAY AND ETOL I TO III TRANSACTIONS WERE TO SURVIVE THE REPOSE PERIOD, ALLEGATIONS OF INVOLVEMENT IN THESE DIVERSE, UNRELATED SETS OF TRANSACTIONS FAIL TO STATE A PRIMARY SECURITIES LAW VIOLATION.

Even if the Sarbanes-Oxley time-bar rule were applied to Plaintiffs' claims against RBSG, they still fail to plead a primary violation of Section 10(b) by RBSG. If Sarbanes-Oxley applies, Plaintiffs plead essentially two transactional situations that supposedly constitute a primary violation of the securities laws. Those disparate events are separated in time by many months and in the later instances by well over a year, and are of different types and connected to different corporate periods: (1) the "Nixon" Prepay, an alleged commodities (or loan) transaction in December 1999 connected with pre-merger The Royal Bank of Scotland plc;[13] and (2) ETOL I-III, alleged FAS 140 activities regarding a UK power plant in November 2000/March 2001/June 2001 connected with post-merger RBSG. Plaintiffs do not dispute that Enron proposed these transactions to RBSG, nor do they assert that RBSG designed, controlled, structured or directed these transactions. These disparate transactions do not rise to the level of a primary "scheme" to defraud as required to state a private claim for violation of Section 10(b).

[13] Plaintiffs imply that the allegations of this single "prepay" suffice to show active, deceptive conduct because this Court has previously upheld claims against Citigroup and JP Morgan based on their participation in multiple prepays and many other transactions. (Pls. Opp. at 29.) In upholding those claims, though, this Court emphasized that all of the alleged conduct "in combination" rose to the level of a primary violation. *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 695 (S.D. Tex. 2002). As this Court's March 29 Order makes clear, allegations of a single wrongful transaction -- and here, as respects prepays, RBSG is accused of only a single transaction, in sharp contrast to the multiple, systematic prepays supposedly undertaken by certain others -- do not suffice when the transaction does not appear in conjunction with numerous other transactions. (Mar. 29 Order at 75 (dismissing Section 10(b) claims "based on a single tax scheme").)

The allegations against RBSG stand in stark contrast to those against Arthur Andersen in the *Global Crossing* case that were recently found sufficient to state a claim for a primary violation. In *Global Crossing*, the court held that the complaint went "beyond mere aiding and abetting" because it pled that Andersen "*masterminded* the misleading accounting for IRUs and the subsequent sham swap transactions . . . ." *In re Global Crossing, Ltd. Sec. Litig.*, Case No. 1:02-Civ.-910 (GEL), Opinion and Order at 22-23 (S.D.N.Y. Mar. 23, 2004) (emphasis added). Andersen allegedly "actively participated in *structuring* each swap, . . . was *intimately involved in all* of [Global Crossing's] accounting functions, and . . . *directly participated in the creation* of the misleading 'pro forma' numbers . . . ." *Id.* at 23 (emphasis added). In short, Andersen was alleged to be a "chief architect and executor" of the alleged accounting fraud. *Id.*

In contrast, Plaintiffs here have not alleged that RBSG masterminded or structured transactions, was intimately involved with any -- let alone all -- of Enron's accounting functions, directly participated in creating misleading numbers, or was the "architect and executor" of the allegedly improper accounting. Plaintiffs' claims must be dismissed for failure to plead a primary violation by RBSG.[14]

[14] For the reasons set out in its opening brief, RBSG believes that Plaintiffs have not adequately pled loss causation as to RBSG. In light of this Court's March 29 Order, in which the Court took a contrary position as to a different defendant but generally applicable to RBSG's circumstances, RBSG will not further argue the point but preserves the issue for appeal.

VI. CONCLUSION

For these reasons, Plaintiffs' claims against RBSG must be dismissed.

Dated: April 5, 2004

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing document has been served upon all counsel of record by sending a copy to the www.esl3624.com website on this 5th day of April, 2004.

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EXHIBIT A

Federal Document Clearing House

Testimony
July 23, 2002

Senate
Governmental Affairs
Permanent Subcommittee on Investigations

Financial Institutions and Collapse of Enron

STATEMENT OF ROBERT ROACH
CHIEF INVESTIGATOR

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON SENATE GOVERNMENTAL AFFAIRS

THE ROLE OF THE FINANCIAL INSTITUTIONS IN ENRON.S COLLAPSE

July 23, 2002

Mr. Chairman, Ranking Member, Members of the Subcommittee, good morning.

Earlier this year Chairman Levin directed the Subcommittee staff to investigate the role of financial institutions in Enron.s collapse. The Subcommittee staff - both Democratic and Republican - have worked for the past 7 months on a bipartisan basis to conduct this investigation. We have worked together to review over a million pages of documents and interview dozens of witnesses from Enron, Andersen, other accounting firms, credit rating agencies, and a host of financial institutions including Barclays, Citigroup, Credit Suisse First Boston, FleetBoston, JPMorgan Chase, and Merrill Lynch.

Numerous major financial institutions, both here and abroad, engaged in extensive and complex financial transactions with Enron. The evidence we reviewed showed that, in some cases, the financial institutions were aware that Enron was using questionable accounting. Some financial institutions not only knew, they actively aided Enron in return for fees and favorable consideration in other business dealings. The evidence indicates that Enron would not have been able to engage in the extent of the accounting deceptions it did, involving billions of dollars, were it not for the active participation of major financial institutions willing to go along with and even expand upon Enron.s activities. The evidence also indicates that some of these financial institutions knowingly allowed investors to rely on Enron financial statements that they knew or should have known were misleading.

Our investigation, among other things, focused on one financing vehicle known as a ..prepay... A prepay is commonly thought of as an arrangement in which one party pays in advance for a service or product to be delivered at a later date. Companies use prepays to receive money up front for services to be rendered in the future. Enron constructed elaborate, multiparty commodity trades that they called prepays in order to book the proceeds from the prepays as cash flow from operations. But when all the bells and whistles are stripped away, the basic transaction fails as a prepay and what remains is a loan to Enron using a bank and an obligation on Enron.s part to repay the principal plus interest. With that being true, the proceeds of the so-called prepay transaction should have been booked as debt and cash flow from financing, not as a trading liability and cash flow from operations. In order for transactions like the ones used by Enron and the banks to be legitimately booked as a trading liability and not debt, four elements had to be present:

- The three parties had to be independent.

- The trades among the three parties could not be linked.

- The trades had to contain price risk.

- There had to be a legitimate business reason for the trades.

The Enron type prepays we examined failed on all accounts:

- Two of the three parties in the Enron trades were related, that is the banks and their offshore special purpose entities which the banks established and controlled.

- The trades among the parties were linked, that is contracts associated with the trades were designed so that a default in one trade affected the other trades.

- There was no price risk. Except for fees and interest payments, the final impact of the trades was a wash.

- Neither the banks nor the banks. special purpose entities had a legitimate business reason for purchasing the commodities used in the trades.

Let me describe the structure and operation of these sham prepays. [Appendix C and Appendix D that discuss the details of the prepays have been submitted for the record.] Enron used these so-called ..prepay..transactions to obtain more than $8 billion in financing over approximately 6 years, including $3.7 billion from 12 transactions with Chase and $4.8 billion from 14 transactions with Citgroup. This $8 billion figure is a conservative estimate for the 6 year period, based on the documents we were able to review; the full amount since Enron began using prepays in 1992 may be much larger. Barclays, Credit Suisse First Boston, FleetBoston, Royal Bank of Scotland, and Toronto Dominion participated in over $1 billion of the prepay transactions. Accounting for ..prepay..proceeds as cash flow from operations, rather than cash from financing gave the impression that the money from the prepays was part of Enron.s ordinary business activities and not debt.

Moreover, the Subcommittee has learned that Enron was simultaneously treating the prepay transactions as loans on its tax returns in order to claim the interest expense as a business deduction. Enron.s practice of using prepay transactions to understate debt and overstate cash flow from operations made its financial statement look much stronger. That, in turn, helped Enron maintain its investment grade credit rating and support, even boost, its share price.

The Subcommittee has done an analysis of what Enron.s financial statements would have looked like had it accurately recorded the ..prepay..transactions as debt. Please look at this chart, which is marked as Exhibit 104. The chart shows key figures from Enron.s year 2000 financial statements, the last audited financial statements that the company filed with the Securities and Exchange Commission. The financial statements showed that Enron had total debt in 2000 of about $10 billion, and funds flow from operations in the range of $3.2 billion. We know from an Enron Board presentation that, at the end of 2000, Enron had about $4 billion in outstanding financing from its so-called ..prepays...

If Enron had properly accounted for these transactions, its total debt would have increased by about 40% to about $14 billion, and its funds flow from operations would have dropped by almost 50% to about $1.7 billion. Those are dramatic changes. The impact on Enron.s key credit ratios would also have been significant. These credit ratios are the ratios that financial analysts typically use to evaluate a company.s financial health. With the inclusion of the prepays as debt, Enron.s debt to equity ratio would have risen from about 69% to about 96%. Its debt to total capital ratio would have risen from 40% to 49%. And its funds flow interest coverage, a key measure of a company.s ability to meet its financing obligations, would have dropped by almost half, from 4.07 to 2.37. The credit rating agencies testifying in the next panel will discuss the significant effect these numbers would have had on Enron.s credit rating.

Any credit rating downgrade would have had serious consequences for Enron, including raising its borrowing costs, limiting the investors who could buy the company.s bonds, weakening its trading status, and possibly triggering certain demand debt repayments at off balance sheet entities affiliated with the company. Enron was acutely aware of the importance of its credit rating and its financial ratios.

The Subcommittee staff has additional analysis regarding the financial impact that would have resulted if Enron had accurately reflected its ..prepay.. proceeds as debt, including drops in the company.s enterprise value and a significant drop in its implied share price. In the interests of time, however, I will submit that analysis for the record and answer any questions you may have about it. I also ask that the other appendices to my statement be included in the Subcommittee.s hearing record.

Enron was able to book ..prepay.. proceeds as cash flow from energy trades rather than cash flow from loans only with the assistance of the financial institutions. The banks provided the funding for the prepays, participated in the required complex commodity trades, and allowed Enron to use their offshore entities that they controlled as sham trading partners, for the explicit purpose of allowing Enron to disguise multi-million-dollar loans as trading activity. Internal communications show that it was common knowledge among Enron, Chase and Citigroup employees that the ..prepays.. were designed to achieve accounting, not business, objectives and that Enron was booking the ..prepay.. proceeds as trading activity rather than debt. The evidence indicates that Chase and Citigroup not only understood Enron.s accounting goal - increasing operating cash flow without reporting debt - but designed and implemented the financial structures to help Enron achieve its objective. Moreover, they accepted and followed Enron.s desire to keep the nature of these transactions confidential.

By design and intent, the prepays as structured by Enron and the financial institutions made it impossible for investors, analysts and other financial institutions to uncover the true level of Enron.s indebtedness. Despite its desire to keep the information confidential, Enron dealt with so many financial institutions that word of its ..prepay..structures began to circulate. Chase developed a ..pitch book..to sell other companies on Enron-style prepays. The presentation describes the transactions as ..Balance sheet .friendly.. ..It also sets out in general terms Chase.s use of its special purpose entity, Mahonia, in structuring the trades and clearly explains that the trades are orchestrated to work together. This explanation of the deliberate packaging of the trades flatly contradicts claims that the trades are independent and unrelated. Chase apparently entered into Enron-style prepays with seven companies apart from Enron.

Citigroup also developed a presentation to sell companies on Enron-style prepays, promoting, in particular, the Yosemite structure it had developed to raise the money for the prepays from third party investors without explicitly informing them of the transactions. The presentation boasts that the structure

..[e]xpands capability to raise non-debt financing and ... improve cash flows from operations..and ..[e]liminates the need for Capital Market disclosure, keeping structure mechanics private... Citigroup shopped this Enron-style prepay to 14 companies, successfully selling it to at least three.

Enron is not the only company obtaining loans disguised as commodity trades, and recording cash flows from operations instead of from financing. Major financial institutions are knowingly assisting and even promoting such transactions, which would not be possible without their willingness to provide the funds, the paperwork, and a sham offshore trading partner. Thank you. Mr. Brown and I would be happy to answer any questions.

ROBERT ROACH

Chief Investigator

Permanent Subcommittee on Investigations

2002 WL 1613793 (F.D.C.H.)

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EXHIBIT B

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PUBLIC DOCUMENT COUNT: 2
CONFORMED PERIOD OF REPORT: 20010930
FILED AS OF DATE: 20011119

FILER:

COMPANY DATA:
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CENTRAL INDEX KEY: 0001024401
STANDARD INDUSTRIAL CLASSIFICATION: SECURITY BROKERS, DEALERS &
IRS NUMBER: 470255140
STATE OF INCORPORATION: OR
FISCAL YEAR END: 1231

FILING VALUES:
FORM TYPE: 10-Q
SEC ACT: 1934 Act
SEC FILE NUMBER: 001-13159
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BUSINESS ADDRESS:
STREET 1: 1400 SMITH ST
CITY: HOUSTON
STATE: TX
ZIP: 77002-7369
BUSINESS PHONE: 7138536161

MAIL ADDRESS:
STREET 1: 1400 SMITH ST
CITY: HOUSTON
STATE: TX
ZIP: 77002-7369

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended SEPTEMBER 30, 2001

Commission File Number 1-13159
ENRON CORP.
(Exact name of registrant as specified in its charter)

Oregon	47-0255140
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
Enron Building 1400 Smith Street Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

(713) 853-6161

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X]   No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 31, 2001
Common Stock, No Par Value	743,904,638 shares

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ENRON CORP. AND SUBSIDIARIES

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Consolidated Balance Sheet - September 30, 2001 and December 31, 2000
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EXPLANATORY NOTE

As explained in a November 8, 2001 Form 8-K filed by Enron Corp. (Enron) with the Securities and Exchange Commission (SEC), Enron will be filing restated consolidated financial statements for the fiscal years ended December 31, 1997 through 2000 and for the first and second quarters of 2001 but it has not yet done so. As a result, the previously issued financial statements for these periods and the audit reports covering the year-end financial statements for 1997 through 2000 should not be relied upon. In addition, as discussed in Note 2 herein, Enron's Board of Directors has formed a Special Committee to conduct an independent investigation and review of transactions between Enron and certain related parties. The Special Committee has retained the law firm of Wilmer, Cutler & Pickering (Wilmer, Cutler) as its counsel. Wilmer, Cutler has retained Deloitte & Touche LLP to provide related accounting advice to the law firm. The

. . . [pages omitted]

adjust ments and reclassifications	(79)	(68)	(68)	
TOTAL ASSETS RESTATED	$22,924	$29,442	$33,272	$64
Debt as reported	$ 6,254	$ 7,357	$ 8,152	$10
Restatements:				
Consolidation of JEDI and Chewco	711	561	685	
Consolidation of LJM1 subsidiary	-	-	-	
Raptor equity adjustment	-	-	-	
Prior period proposed audit adjustments and reclassifications	-	-	-	
DEBT RESTATED	$ 6,965	$ 7,918	$ 8,837	$10
Equity as reported	$ 5,618	$ 7,048	$ 9,570	$11
Restatements:				
Consolidation of JEDI and Chewco	(258)	(391)	(544)	
Consolidation of LJM1 subsidiary	-	-	(166)	
Raptor equity adjustment	-	-	-	
Prior period proposed audit adjustments and reclassifications	(51)	(57)	(136)	
EQUITY RESTATED	$ 5,309	$ 6,600	$ 8,724	$10

</TABLE>

(a) After effect of significant contract restructuring charge totaling $463 million (after tax).

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DESCRIPTION OF RESTATEMENT ITEMS

Chewco and JEDI Consolidation. Enron's decision that Chewco should be consolidated beginning in November 1997 is based on recently obtained information that Chewco did not meet the accounting criteria to qualify as an adequately capitalized unconsolidated special purpose entity (SPE). See Note 4 for a discussion of Chewco and a description of an SPE. As a result of Chewco's failure to meet these criteria, JEDI, in which Chewco was a limited partner, also did not qualify for nonconsolidation treatment. When the consolidation of these two entities are taken into account, Enron's prior-year reported debt amounts are increased by both JEDI's and Chewco's borrowings. In addition, Enron's net income is reduced for specific JEDI revenues previously allocated to Chewco, relating to the appreciation in value of Enron stock held by JEDI, which eliminates upon consolidation. This, in effect, reduces Enron's share of JEDI's earnings. The net effect reduces Enron's prior-years' reported net income and shareholders' equity amounts.

LJM1 Subsidiary Consolidation. Enron's decision that the LJM1 subsidiary should be consolidated in 1999 and 2000 is based on Enron's current assessment that the subsidiary did not qualify for nonconsolidation treatment because of inadequate capitalization.

In 1999, Enron entered into a series of transactions involving a third party and LJM1. The effect of the transactions was (i) Enron and the third party amended certain forward contracts to purchase shares of Enron common stock, resulting in Enron having forward contracts to purchase Enron common shares at the market price on that day, (ii) LJM1 received 6.8 million shares of Enron common stock subject to certain restrictions, 3.1 million shares of which it contributed to the LJM1 subsidiary and (iii) Enron received a note receivable from LJM1, which was repaid in December 1999, and certain financial instruments hedging Enron's investment in the stock of Rhythms NetConnections, Inc. Enron recorded the assets received and equity issued at estimated fair value. In connection with the transactions, LJM1 agreed that Mr. Fastow would have no pecuniary interest in such Enron common shares and would be restricted from voting on matters related to such shares. In March 2000, Enron and LJM1 entered into an agreement to terminate the financial instruments. In connection with this agreement, Enron received the 3.1 million shares of Enron common stock held by the LJM1 subsidiary. A put option, which was originally entered into in the first quarter of 2000 and gave LJM1 the right to sell shares of Enron common stock to Enron at a strike price of $71.31 per share, was terminated under this agreement. In return, Enron paid approximately $26.8 million to LJM1.

Consolidation of the LJM1 subsidiary has the effect of eliminating the income recognized by Enron on derivative transactions with this LJM1 subsidiary, thus reducing Enron's net income in 1999 and 2000. Shareholders' equity has been reduced in 1999 and increased in 2000 to reflect the elimination of Enron common stock contributed by LJM1 to the LJM1 subsidiary.

Shareholders' Equity Reduction. Enron's previously-announced $1.2 billion reduction of shareholders' equity primarily involves the correction of an accounting error made in the second quarter of 2000 and in the first quarter of 2001. As described in more detail below and in Note 4, four SPEs known as Raptor I-IV (collectively, Raptor) were created in 2000 to permit Enron to hedge market risk in certain of its investments. (LJM2 Co-Investment, L.P. (LJM2), a private investment limited partnership for which the general partner's managing member was Mr. Fastow, invested in these entities, but the related-party nature of the transaction is not relevant to the accounting correction.) As part of the capitalization of these entities, Enron issued

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common stock in exchange for a note receivable. Enron increased notes receivable and shareholders' equity to reflect this transaction. Enron now believes that, under generally accepted accounting principles, the note receivable should have been presented as a reduction to shareholders' equity (similar to a shareholder loan). This treatment would have resulted in no net increase to shareholders' equity. The net effect of this initial accounting entry was to overstate both notes receivable and shareholders' equity by approximately $172 million (which represented less than 2% of shareholders' equity at the time) in each of the second quarter, third quarter and year-end financial statements of Enron for the year 2000.

In the first quarter of 2001, Enron entered into a series of transactions with Raptor that could have obligated Enron to issue Enron common stock in the future in exchange for notes receivable. Enron accounted for these transactions using the accounting treatment described in the preceding paragraph. This resulted in an additional overstatement of both notes receivable and shareholders' equity by $828 million. As a result of these errors, shareholders' equity and notes receivable were overstated by a total of $1 billion in the unaudited balance sheets of Enron at March 31, 2001 and June 30, 2001.

In the third quarter of 2001, as a result of deterioration in the credit quality of the Raptor SPEs caused by the decline in New Power Holdings, Inc.'s (NPW) stock price, the increase in Raptor's exposure under derivative contracts with Enron and the increasing dilutive effect on Enron's earnings per share calculation, Enron acquired LJM2's equity in the SPEs for $35 million and terminated the entities. Consistent with the original treatment, Enron accounted for this transaction as a reduction to Enron shareholders' equity and notes receivable by $1.2 billion. Of this amount, $270 million related to the amount by which the fair value of contracts to deliver Enron shares exceeded the value of the notes receivable, which is not related to the restatement discussed above.

Audit Adjustments. The restatements include prior-year proposed audit adjustments and reclassifications which were determined to be immaterial in the periods originally proposed.

4. RELATED PARTY TRANSACTIONS

On November 8, 2001, Enron released information in a Form 8-K regarding the two LJM limited partnerships formed by Enron's former chief financial officer, his role in the partnerships, the business relationships and transactions between Enron and the partnerships, and the economic results of those transactions as known thus far, and transactions between Enron and certain other Enron employees. Following is the information that was provided.

THE LJM LIMITED PARTNERSHIPS AND TRANSACTIONS WITH ENRON. LJM1 and LJM2 (collectively, LJM) are private investment limited partnerships that were formed in 1999. Andrew S. Fastow was (from inception through July 2001) the managing member of the general partners of LJM1 and LJM2. Enron believes that the LJM partnerships have as limited partners a significant number of institutions and other investors that are not related parties to Enron. These partnerships are a subject of the Special Committee's investigation and it is possible that this investigation will identify additional or different information concerning matters described herein.

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PART I. FINANCIAL INFORMATION - (CONTINUED)

ITEM 1. FINANCIAL STATEMENTS - (CONTINUED)
ENRON CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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